Woman C.P.A.

Volume 11 | Issue 5 Article 9

8-1949

Some Accounting Problems Peculiar to Investment Bankers

Heloise Brown

Heloise Brown is the immediate past president of AWSCPA and has lent her abilities to many posts in that organization.

She is a graduate of Mary Hardin-Baylor College and in 1945, at the 100th anniversary of the college, was honored as having achieved distinction in the field of business administration.

While president of AWSCPA she was selected by the Business and Professional Women's Club of Houston as Houston's outstanding business woman of the year. In 1948 she was appointed to the advisory board of the International Accountants Society.

As an official delegate of the American Institute of Accountants and of AWSCPA and ASWA she attended, in May of this year, the First Inter-American Conference in Accounting, held in San Juan, and there addressed the conference on the subject of the accounting problems of investment bankers. We have pleasure in publishing her paper.

Previously connected with the Butcher-Arthur interests, she now conducts a public accounting practice from her offices in the City National Bank Building in Houston. She is active in the work of the Texas Society of CPA's.

SOME ACCOUNTING PROBLEMS PECULIAR TO INVESTMENT BANKERS

By HELOISE BROWN, C.P.A.

Business and industry, regardless of the form of government under which they operate, are the life-blood of the nation. Our modern economic system could not have reached the present level of development were it not for the capital made available for free and private enterprise. The most skilled workman—working without sufficient capital—accomplishes little. Thus we find it necessary to provide capital for the support of industrial enterprises so they may continue to grow and develop. New capital is required for new businesses, to expand old businesses, and to develop new products; new capital is also required by state and local governments to fulfill their municipal obligations.

Reinvested earnings and cash accumulated out of past earnings are one great source of capital; but there are instances where capital from internal sources either is unavailable or is insufficient. Therefore, businesses must secure funds through bank loans or from stock and bond issues. In such cases the investment bankers are called upon to provide this additional capital through the distribution of securities of businesses among investors. They are the middlemen between the issuer of securities and the investing public. Their business consists of purchasing whole issues from corporations or governmental units and distributing them to investors. An investment banker, acting in this capacity, must negotiate with the corporation selling the new issue of securities, arrange for an underwriting group of other bankers to participate in the underwriting, thereby dividing the liability and risk, and organize a group of dealers in a selling group to distribute the securities to the public. All of the accounting in the underwriting is handled by the manager who must maintain adequate records to record the percentage of participation of each member, the amount of securities given up to the selling group, any unsold securities coming back to the underwriters from the selling group, the expenses incurred by the underwriters, and the distribution of whatever profit or loss remains in the account as a result of the underwriting. In the case of bonds, records must also be maintained to record good faith deposits and the take-down on bonds by the purchasers.

Another function of the investment bankers or security dealers is to effect transfer of ownership of existing securities. This is accomplished through the securities exchanges and through the over-the-counter markets.

It might be mentioned that until the enactment of the Securities Act of 1933 and the Securities Exchange Act of 1934, the securities industry had developed without any control emanating from federal statute.

Many of the states had anti-fraud or "blue-sky" laws in effect—but these had special application to the character of individual securities in which dealings were permitted within their state borders.

The Securities Act of 1933, which regulates the underwriting and distribution of new securities, and the Securities Exchange Act of 1934, which regulates trading in already issued securities, are administered through the Securities and Exchange Commission. When these acts were passed it was practicable to regulate the stock exchanges because they were organized and functioned as units. However, the over-the-counter dealers were not organized as such; so it was impossible to undertake regulation of over-the-counter securities immediately. This term "over-the-counter" (unlisted securities) applies to all securities transactions that take place without benefit of the facilities of an organized stock exchange.

The Maloney Act was introduced as an amendment (15A) to the Securities Act "to provide for the establishment of a mechanism of regulation among over-the-counter brokers and dealers operating in interstate and foreign commerce or through the mails, to prevent acts and practices inconsistent with just and equitable principles of trade, and for other purposes." This Act passed the Congress in June of 1938 and the National Association of Securities Dealers was formed. It is the only association operating under the Maloney Act. Its authority and its powers extend beyond criminal or civil jurisdiction. Its primary concern is with principles, business morals, and ethics, and it provides regulation for the over-the-counter business similar to that provided by the national stock exchanges for its members. The Association is empowered to inspect members' books and records to ascertain if rules are violated. These inspections are made at frequent intervals regardless of a suspicion of violation.

Thus it develops that the accounting practices followed by investment bankers must be designed to satisfy management and also to meet the requirements of the various governmental and regulatory bodies. The accounting necessary in the securities house is unique in requiring a complete accounting not only of all cash items but also of all securities of the firm and of all securities for which the firm is accountable to others.

Under the provisions of the Securities Exchange Act of 1934, the Securities and Exchange Commission requires that the following accounts be maintained:

1. A daily record of all purchases and sales of securities,
2. A daily record of cash receipts and disbursements,
3. A daily record of all receipts and deliveries of securities,
4. Ledger accounts reflectiig all assets and liabilities, income and expense and capital accounts,
5. Ledger accounts itemizing separately as to each customer's account all purchases, sales, receipts and deliveries of securities for such account and all other debits and credits to such account,
6. Ledgers or other records reflecting the following:
   a. Securities in transfer,
   b. Dividends and interest received,
   c. Securities borrowed and securities loaned,
   d. Monies borrowed and monies loaned (together with a record of the collateral therefor and any substitutions in such collateral),
   e. Securities failed to receive and failed to deliver.
7. A securities record or position blotter accounting separately for each security for which the dealer is accountable and the manner in which they are accounted for. This would reflect the clearance dates on all long or short positions showing the location of all securities long and the offsetting position of all securities short and in cases the name or designation of the account in which each position is carried.

The SEC also requires that written memoranda be kept of all orders and instructions received from customers or other dealers for the purchase and sale of securities and that all orders and instructions (including interoffice memoranda and communications) as well as copies of confirmations of all purchases and sales, receipts, deliveries and other items be prepared and preserved.

The SEC and the NASD forbid the hypothecation of any securities carried for the account of any customer under circumstances:

1. that will permit the commingling of securities carried for the account of any such customer with securities carried for the account of any other customer, without first obtain-

ing the written consent of each such customer to such hypothecation;
2. that will permit such securities to be commingled with securities carried for the account of any person other than a bona fide customer of the broker or dealer under a lien for a loan made to such broker or dealer; or
3. that will permit securities carried for the account of customers to be hypothecated or subjected to any lien or claim for a sum which exceeds the aggregate indebtedness of all customers in respect of securities carried for their accounts.

The Securities Exchange Act of 1934 further provides that the Federal Reserve Board shall prescribe rules and regulations with respect to the amount of credit that may be initially extended and subsequently maintained on securities. Regulation T has been issued pursuant to this provision. Among other things, it prescribes that full payment must be made by the purchaser on or before the close of business on the seventh calendar day from the date of the transaction. If payment has not been received by this date, the broker/dealer should cancel or otherwise liquidate the transaction unless an extension for delayed payment has been granted by the National Association of Securities Dealers. The Regulation also provides that if a security is either delivered to another broker/dealer or is sold before being paid for in full, the account must be frozen for a period of 90 days. Subsequent purchases can be effected only if cash is on hand prior to the execution, or if proper authorization is secured from the NASD.

The Federal Government imposes a tax on the sale of stocks and bonds. Some states have enacted laws subjecting the sale of stock to state transfer taxes. These taxes are collected in the form of revenue stamps which the broker affixes to the stock certificates or on memoranda of sales or tax bill to accompany the stock certificate to the transfer agent. The broker or dealer is responsible for the payment of these taxes on sales negotiated by him and is therefore required to keep a record of his tax stamps.

Accounting for dividends presents another problem. Dividends are paid to stockholders of record as of the record date, irrespective of actual ownership. Stock may be carried in a dealer's name, even though it may not be owned by him. Therefore each dividend received must be analyzed to determine rightful ownership. Frequently a dealer will not receive a dividend to which he is entitled because stock held by him did not reach the transfer agent in time for transfer, or the stock owned by him is carried in street name. Claim for this dividend may be made by writing to the person in whose name the certificate was registered on the record date. Under any circumstances, an analysis of the position ledger will determine who is entitled to the dividend.

WHAT'S NEW IN READING

STANDARDIZED AUDIT WORKING PAPERS, by Frederick Staples, CPA. (The Counting House Publishing Co., Milwaukee, Wis., 1949. 279 pages. $4.50.)

Mr. Staples has drawn upon his years of experience as a practicing public accountant in devising a set of standardized working papers and marshaling the arguments for their use. A set of them, completely filled out, together with the final report prepared therefrom, is reproduced in the book.

The standardized papers are forms which may be purchased separately. They are well devised to assure that the necessary audit procedures are followed and the required information obtained. Designed for the average audit, they are flexible in application and include forms for confirmation requests and certificates to be furnished by the client. There is also a chapter which delineates the general instructions usually covered in the manual of procedure furnished by most accountants to staff members.

Those who claim that standardized forms stifle initiative will nevertheless concede the safeguards which this carefully devised plan provides. The book will be of inestimable value to the young accountant and can be relied upon to furnish many ideas to the more experienced practitioner.

The book is a revision, with improved format, of the 1947 edition. The price has not increased.

CONGRATULATIONS

Linda Stanford, a member of AWSCPA, has been elected president of the Binghamton, New York, chapter of NACA and is, we understand, the first woman in NACA history to hold the office of chapter president. She is auditor and a member of the board of directors of Endicott Johnson Corporation.